

Decision **PROPOSED DECISION OF ALJ BARNETT** (Mailed 12/11/2012)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Pacific Gas and Electric Company (U39E) for Approval of an Amendment of its Power Purchase Agreement with Starwood Power-Midway, LLC and for Authority to Recover the Costs of the Amended Agreement in Rates.

Application 12-09-016  
(Filed September 26, 2012)

**DECISION GRANTING THE APPLICATION OF PACIFIC GAS AND ELECTRIC COMPANY (U39E) FOR APPROVAL OF AN AMENDMENT OF ITS POWER PURCHASE AGREEMENT WITH STARWOOD POWER-MIDWAY, LLC****1. Summary**

This decision grants the Application of Pacific Gas and Electric Company for approval of an amendment of its Power Purchase Agreement with Starwood Power-Midway, LLC.

**2. Introduction and Overview of Application**

Pacific Gas and Electric Company (PG&E) seeks approval of an amendment (Amendment) to the Power Purchase Agreement (PPA) between Starwood Power-Midway, LLC (Starwood) and PG&E. The PPA was approved by Decision (D.) 06-11-048. The Amendment provides that PG&E will pay Starwood an amount that Starwood will apply towards its Assembly Bill (AB) 32<sup>1</sup> carbon dioxide compliance costs that result from PG&E's dispatch of Starwood's

generating facility under the PPA (Defined Carbon Dioxide (CO<sub>2</sub>) Costs) in exchange for a contract price reduction.

Through an Assigned Commissioner's and Administrative Law Judge's Ruling (ACR) issued in the Greenhouse Gas (GHG) Rulemaking,<sup>2</sup> the Commission recently stated it would review the issues of GHG compliance cost recovery for power purchase agreements executed before the passage of AB 32 that have no such mechanism. However, the ACR encouraged parties "to reach agreement on contract terms rather than ask for terms to be imposed by this Commission."<sup>3</sup> Accordingly, Starwood and PG&E entered into negotiations and have agreed that PG&E will compensate Starwood with Defined CO<sub>2</sub> Costs in exchange for a contract price reduction for the benefit of PG&E's customers.

PG&E argues that the Amendment merits approval because it takes account of the balance of costs and benefits as agreed upon during contract negotiation and subsequently represented in the PPA, provides substantial benefits for PG&E's customers compared to the potential outcomes of regulatory or adversarial proceedings that would be risked in the absence of a negotiated compromise, and demonstrates that parties to a pre-AB 32 PPA can successfully agree to realign their obligations for AB 32 costs or "GHG compliance costs" so

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<sup>1</sup> Stats. 2006, ch. 488.

<sup>2</sup> *Rulemaking to Address Utility Cost and Revenue Issues Associated with greenhouse gas Emissions (R.)* 11-03-012.

<sup>3</sup> *Assigned Commissioner's and Administrative Law Judge's Ruling Amending Scoping Memo, R.11-03-012*, August 2, 2012 at 6 and 7.

that regulatory intervention is unnecessary. Amendment approval is sought by application because the Amendment term exceeds five years.<sup>4</sup>

Accordingly, PG&E requests the Commission approve the Amendment, find that its terms are reasonable and in the interests of PG&E's customers, and authorize rate recovery by PG&E of costs incurred under the PPA as amended (Amended PPA), subject only to Commission review of the prudence of PG&E's administration of the Amended PPA.

### **3. Description of the Starwood Transaction**

PG&E asserts that the Starwood PPA's contract price takes into account Starwood's responsibility for GHG compliance costs. The Amendment preserves the value of the PPA by providing a contract price reduction to PG&E in exchange for PG&E's payment of Starwood's Defined CO<sub>2</sub> Costs under circumstances specified by the Amendment.

#### **Basic Terms of the Amended PPA**

Generating Facility	Starwood
Resource Type	Simple Cycle Gas Turbine
Location	Firebaugh, CA
Nameplate Capacity	120 megawatts
Expected Deliveries	Dispatchable
Delivery Point	Panoche Substation
Term	5/1/2009 through 5/1/2024 with approximately 11 years remaining

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<sup>4</sup> "Contracts with duration five years or longer must be submitted with an application to the Commission for preapproval." D.04-12-048 at 108. The Amended PPA will have a remaining term of approximately eleven years.

Amendment Start Date	Earlier of the start of the Cap and Trade Program compliance period (currently expected to be 1/1/2013) or date Amendment receives CPUC Approval
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#### **4. Consistency With Commission Decisions**

##### **4.1. CPUC Consideration of GHG Cost Responsibility**

In 2011, the California Air Resources Board (CARB) adopted the “California Cap on GHG emissions and Market-Based Compliance Mechanism,” commonly known as California’s “Cap and Trade” regulation.<sup>5</sup> In its Final Statement of Reasons regarding Cap and Trade, CARB indicated that insofar as existing contracts might not include provisions allowing full pass-through of carbon costs associated with Cap and Trade, its staff believed that bilateral contract negotiations would provide the best resolution of the issue.<sup>6</sup>

In its recent decision in the long-term procurement plan proceeding, R.10-05-006, the Commission considered the request of the Independent Energy Producers Association (IEPA) to determine the treatment of GHG compliance costs associated with contracts executed between independent generators and

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<sup>5</sup> “The purpose of this article is to reduce emissions of greenhouse gases associated with entities identified in this article through the establishment, administration, and enforcement of the California Greenhouse Gas Cap-and-Trade Program by applying an aggregate GHG allowance budget on covered entities and providing a trading mechanism for compliance instruments.” Title 17, California Code of Regulations (CCR), Section 95801.

<sup>6</sup> CARB, *California’s Cap and Trade Program – Final Statement of Reasons (FSOR)*, October 2011 at 25. <http://www.arb.ca.gov/regact/2010/capandtrade10/fsor.pdf>.

utilities prior to the passage of AB 32 that do not include a mechanism for recovery of such costs. In response, the Commission stated:

... (C)ontracts negotiated and executed when AB 32 was working its way through the legislature should have taken the potential impacts of AB 32 into consideration.

Even those negotiating contracts shortly before then might also have reasonably foreseen that this issue could arise.<sup>7</sup>

It declined to make the requested determination and instead stated:

The parties should be able to renegotiate any contracts that currently do not address the allocation of AB 32 compliance costs, so that the contracts are modified to be consistent with Commission policy. Rather than rewrite the existing contracts based on the limited record before us, we direct the utilities to renegotiate the contracts at issue so that they reasonably address the allocation of AB 32 compliance costs.<sup>8</sup>

Both the Commission and CARB have encouraged contracting parties to resolve the issue of responsibility for GHG compliance costs in pre-AB 32 power purchase agreements through bilateral negotiations. Here, a dispute arose between PG&E and Starwood as to whether the PPA addresses GHG compliance costs. PG&E contends that the PPA does so and that it allocates such costs to Starwood. Starwood, however, disputes PG&E's position and sought compensation from PG&E for its GHG compliance costs. To resolve this dispute, and pursuant to the Commission's guidance, the parties agreed to compromise their dispute. Specifically, PG&E and Starwood negotiated a contract price reduction to retain value for PG&E's customers in exchange for compensating

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<sup>7</sup> *Opinion Adopting PG&E, Southern California Edison Company and San Diego Gas & Electric Company's Long-Term Procurement Plans (LTPP Decision) D.12-04-046 at 61.*

<sup>8</sup> *LTPP Decision, D.12-04-046 at 62.*

Starwood with Defined CO<sub>2</sub> Costs. PG&E and Starwood have memorialized their agreement in the Amendment, which will become effective upon final approval by the Commission.

#### **4.2. Consistency with Commission Rulings**

PG&E and Starwood's bilateral negotiation of a mutually satisfactory resolution of responsibility for GHG compliance costs is precisely what was encouraged. Starwood has sought to reopen its contract to obtain compensation for its GHG emissions costs from the Facility from PG&E. The parties have discussed the merits of their respective positions on GHG compliance cost allocation and negotiated a compromise in the form of the Amendment. The Amendment allows the parties to avoid a broad-brush regulatory solution that would not necessarily preserve the value of the negotiated terms and conditions of the PPA and could result in a less valuable PPA for PG&E's customers. The Amendment also avoids a dispute process between the parties that could be lengthy and costly. PG&E requests a finding that PG&E acted prudently in negotiating the Amendment.

#### **4.3. PG&E's Customers Benefit from the Amendment**

PG&E argues that although PG&E will pay Starwood for Defined CO<sub>2</sub> Costs under the Amendment, value from Starwood's pre-existing obligation is recognized because the Amendment includes a purchase price reduction. The actual commercial terms of the Amendment are described in detail in confidential Appendix A and the Amendment itself is provided as Appendix B to the application. Altogether, PG&E's negotiated resolution of Starwood's claim for assistance with its GHG compliance costs merits Commission approval.

## **5. The Amendment**

### **5.1. General Deal Structure**

PG&E will compensate Starwood for Defined CO<sub>2</sub> Costs resulting from PG&E's dispatch of the Facility through either payments or physical transfer of compliance instruments such as allowances or offsets. In exchange, Starwood will accept a reduction in certain contract payments. Starwood must demonstrate to PG&E that it actually has a compliance obligation to CARB for the Facility and must provide PG&E with its Facility Emissions Report when it makes its filing with CARB.

### **5.2. Amendment Terms**

The following is a general description of the major terms of the Amendment. The Amendment terms are market-sensitive and proprietary to Starwood and PG&E; therefore, the details and analysis of these terms are provided in Confidential Appendix A to the application. Capitalized terms have the meaning ascribed to them in the PPA or Amendment, unless otherwise stated.

#### **5.2.1. New Section 9.3 Concerning Carbon Dioxide Costs**

The scope and mechanics of PG&E's compensation for Defined CO<sub>2</sub> Costs resulting from PG&E's dispatch of the Facility are explained in this addition to the PPA.

#### **5.2.2. PG&E's Contract Payments Are Reduced**

The PPA's contract price is reduced in consideration of PG&E compensation Starwood for Defined CO<sub>2</sub> Costs. The negotiated price will become effective as of the earlier of the start of the Cap and Trade Program compliance period or Commission approval of the Amendment. This reduction

will be fixed for the remaining contract term whether or not the Cap and Trade program is in effect, unless otherwise modified in a future amendment.

**5.2.3. The Amendment Clearly Defines PG&E's AB 32 Compensation to Starwood**

The Amendment will provide Starwood compensation only towards its carbon dioxide emissions resulting from PG&E's dispatch of the Facility at the contractually guaranteed heat rate.

**5.2.4. The Amendment Covers Certain Contingencies**

If Starwood receives GHG emissions credits with respect to the Facility, it will credit them to PG&E.

**6. Panoche Energy Center, LLC's Response**

Panoche Energy Center, LLC (PEC) responded to PG&E's application and asserts that while it does not dispute PG&E's request for approval of the amended Starwood PPA, PEC disputes PG&E's assertions regarding what independent generators knew and agreed to with respect to AB 32 compliance costs. PEC asserts that in order to avoid the potential for contradictory findings and in order to avoid litigating this issue in two different proceedings, the Commission should defer making findings as to these disputed issues. PEC neither supports nor opposes PG&E's request for approval of the amended Starwood PPA, but disputes PG&E's assertion that all of the sellers entering into long-term PPAs with PG&E in this time frame assumed responsibility for GHG compliance costs. PEC says that the Commission can dispose of PG&E's request for approval of the amended Starwood PPA without making findings as to those disputed issues in this proceeding.

PEC owns the Panoche Energy Center, a 400 megawatt natural-gas fired electrical generating facility in western Fresno County. PEC is a wholly-owned



subsidiary of Energy Investors Fund. PEC sells energy to PG&E under a 20-year PPA, executed March 28, 2006.

We agree with PEC that we can dispose of this application without making findings as to the issues PEC disputes. We are approving a bi-lateral agreement that is not opposed. There are no disputed issues. We make no determination regarding what PG&E and independent generators knew and agreed to with regard to GHG compliance costs.

## **7. Request for Confidential Treatment**

In support of this application, PG&E provides the following confidential appendices:

- **Confidential Appendix A** – Amendment Summary and Analysis evaluating the benefits of the Amendment
- **Confidential Appendix B** – Amendment

PG&E has filed a *Motion for Leave to File Confidential Material Under Seal* to protect from public disclosure confidential market-sensitive information, as defined by R.05-06-040, and other proprietary business information contained in certain appendices to this application. The contract price amendment, other proprietary contract terms, and information about the value of the transaction to PG&E are presented in Appendix A, “Amendment Summary and Analysis.” The confidential Amendment is provided as Appendix B. In accordance with D.08-04-023, PG&E requests the Commission to preserve the continued confidentiality of the Amendment to the PPA, and all other contractual information not required to be made public by D.06-06-066. There is no opposition to the motion. The motion is granted.

The confidential, unredacted version of this information shall remain under seal for three years from the effective date of this decision, and shall not be made accessible or disclosed to anyone other than the Commission and its staff except on the further order or ruling of the Commission, the assigned Commissioner, the assigned Administrative Law Judge (ALJ), or the ALJ then designated as Law and Motion Judge.

#### **8. Categorization and Need for Hearing**

In Resolution ALJ-176-3302, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were necessary. Because this application is not opposed and there are no disputed issues, we determine that hearings are not necessary. The preliminary determination as to category is confirmed.

#### **9. Comments on Proposed Decision**

The proposed decision of Administrative Law Judge (ALJ) Barnett in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. No comments were filed.

#### **10. Assignment of Proceeding**

Mark J. Ferron is the assigned Commissioner and Robert Barnett is the assigned Administrative Law Judge in this proceeding.

#### **Findings of Fact**

1. PG&E executed the PPA, the subject of this application, with Starwood in April 2006.

2. In 2011, the CARB adopted the “California Cap on GHG emissions and Market-Based Compliance Mechanism,” commonly known as California’s “Cap and Trade” regulation. Its purpose is to reduce emissions of greenhouse gases associated with entities such as PG&E and Starwood through the establishment, administration, and enforcement of the California Greenhouse Gas Cap-and-Trade Program by applying an aggregate GHG allowance budget and providing a trading mechanism for compliance instruments.

3. A dispute arose between PG&E and Starwood as to whether the PPA addresses GHG compliance costs. PG&E contends that the PPA does so and that it allocates such costs to Starwood. Starwood, however, disputes PG&E’s position and sought compensation from PG&E for its GHG compliance costs. To resolve this dispute the parties agreed to compromise their dispute. Specifically, PG&E and Starwood negotiated a contract price reduction to retain value for PG&E’s customers in exchange for compensating Starwood with Defined CO<sub>2</sub> Costs. PG&E and Starwood have memorialized their agreement in the Amendment, which will become effective upon final approval by the Commission.

4. PG&E acted prudently in negotiating the Amendment.

5. The Amendment to the PPA provides that PG&E will compensate Starwood for Defined CO<sub>2</sub> Costs resulting from PG&E’s dispatch of the Facility through either payments or physical transfer of compliance instruments such as allowances or offsets. In exchange, Starwood will accept a reduction in certain contract payments.

6. The Amendment to the PPA is reasonable.

**Conclusions of Law**

1. The Amendment to the PPA should be approved. Its terms are reasonable and in the interests of PG&E's customers.
2. It is reasonable for PG&E to recover its costs under the Amended PPA through its Energy Resource Recovery Account.
3. Any stranded costs that may arise from the Amended PPA are subject to the provisions of D.04-01-048 which authorize recovery of stranded procurement costs over the life of the contract. The implementation of the D.04-12-048 stranded cost recovery mechanism is addressed in D.08-09-012.
4. We authorize rate recovery by PG&E of costs incurred under the PPA as amended (Amended PPA), subject only to Commission review of the prudence of PG&E's administration of the Amended PPA.
5. The motion of PG&E for leave to file confidential material under seal consistent with the confidentiality protections of D.06-06-066 and Public Utilities Code Section 583 is granted as set forth below.
6. The preliminary categorization of ratesetting should be confirmed. Hearings are not necessary.

**O R D E R**

**IT IS ORDERED** that:

1. The Amendment of Pacific Gas and Electric Company's (PG&E) Power Purchase Agreement (PPA) with Starwood Power – Midway, LLC in its entirety, including payments to be made by PG&E to the Amended PPA, subject only to the Commission's review of the prudence of PG&E's administration of the Amended PPA, is approved.

2. The confidential, unredacted version of the material placed under seal shall remain under seal for three years from the effective date of this decision, and shall not be made accessible or disclosed to anyone other than the Commission and its staff except on the further order or ruling of the Commission, the assigned Commissioner, the assigned Administrative Law Judge (ALJ) or the ALJ then designated as Law and Motion Judge.

3. Hearings are not necessary.

4. Application 12-09-016 is closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.